

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into
Implementation of Public Utilities Code Section
390.

Rulemaking 99-11-022
(Filed November 18, 1999)

**ADMINISTRATIVE LAW JUDGE'S RULING
REQUESTING COMMENTS AND REPLY COMMENTS
ON SHORT-RUN AVOIDED COST PRICES AND NATURAL GAS INDICES
USED BETWEEN DECEMBER 2000 THROUGH MARCH 2001**

Summary

This ruling provides parties an opportunity to submit comments and reply comments on short-run avoided cost (SRAC) prices and related issues remanded by the California Court of Appeal (Court) in its Opinion filed September 4, 2002.¹ The ruling also provides background and context for considering these issues.

Background

Section 390 of the California Public Utilities Code requires that energy payments to qualifying facilities (QFs) be based on current California natural gas border price indices. Section 390(b) requires the following:

¹ The California Supreme Court denied petitions for review of the Appellate Court's order filed by the California Cogeneration Council (CCC), the Independent Energy Producers Association (IEP), and the Central Hydroelectric Corporation (CHC) on November 26, 2002.

“Until the requirements of subdivision (c) have been satisfied, short run avoided cost energy payments paid to nonutility power generators by an electrical corporation shall be based on a formula that reflects a starting energy price, adjusted monthly to reflect changes in a starting gas index price in relation to an average of current California natural gas border price indices. The starting energy price shall be based on 12-month averages of recent, pre-January 1, 1996, short-run avoided energy prices paid by each public utility electrical corporation to nonutility power generators. The starting gas index price shall be established as an average of index gas prices for the same annual periods.”²

Decision (D.) 01-03-067 adopted an SRAC formula, and replaced the Topock gas index used in the formula, with a gas index at the Malin border point plus intrastate transportation for Southern California Edison Company (Edison), Pacific Gas and Electric Company (PG&E), and San Diego Gas & Electric Company (SDG&E). The Commission adopted Malin as a proxy for the Topock Index as it found that the reduced liquidity in the Topock market, and the possibility of market power abuse on the El Paso pipeline did not reflect a robust market as required in D.96-12-028.³ Petitions for writ of review were filed by Edison, Los Angeles County (County), CCC, IEP, and CHC.

² The requirements of Section 390(c) cannot be met because the Power Exchange (PX) ceased market operations on January 31, 2001. Consequently, the Commission will not have the opportunity to determine whether or not “the independent Power Exchange is functioning properly for the purposes of determining the short-run avoided cost energy payments to be made to nonutility power generators.”

³ At Federal Energy Regulatory Commission (FERC), in its April 4, 2000 Section 5 Complaint (under the Natural Gas Act) in RP00-241-000, the CPUC challenged “the justness and reasonableness and anti-competitive effects of El Paso’s three contracts with El Paso Merchant, which award[ed] El Paso Merchant approximately 1220 MMcf/d of firm capacity rights on El Paso to delivery points at the California border (hereinafter, these three contracts will be collectively referred to as the ‘El Paso-El Paso Contracts’).”

D.01-03-067 also ordered a workshop on the use of natural gas indices and a report to the Commission. The report⁴ discussed various options that might be used in determining gas indices for SRAC formulas. With the expiration of the “El Paso-El Paso” gas contracts on June 1, 2001, gas prices at Topock, as stated in various gas publications returned to historic levels.

On September 4, 2002, the Court affirmed D.01-03-067, and related decisions⁵ of the Commission, except for certain matters regarding SRAC prices for the period December 2000 through March 2001. The Court remanded this issue to the Commission and directed the Commission to determine whether SRAC prices were correct for this period. The Court stated:

“It may be that the evidence will show the SRAC prices were correct for the period of December 2000 through March of 2001. If the [Public Utilities] Commission makes this determination and it is based upon substantial evidence that will end the matter. However, if the evidence shows that the formula in Decision No. 01-03-067 should have been applied retroactively to arrive at a more accurate SRAC, then it is the Commission’s duty to apply it retroactively. The Commission does not have the power to thwart Congressional intent by having a policy inconsistent with that set forth in PURPA [Public Utility Regulatory Policy Act].” (Opinion, p. 20.)

A recent FERC staff report⁶ found preliminary indications of manipulation of spot gas prices during the period of its study that included the period of

⁴ *Final Report on Workshop to Discuss Alternative Gas Indices*, Energy Division, May 1, 2001.

⁵ D.01-12-028 and D.02-02-028.

⁶ Initial Report on Company-Specific Separate Proceedings and Generic Reevaluations, Published Natural Gas Price Data, Enron Trading Strategies, and Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices (Docket No.

Footnote continued on next page

December 2000 through March 2001. Specifically, the report found poor correlation between gas prices in the producing basins and spot prices at California delivery points during the months of October 2000 through July 2001. While this report has not yet been adopted by FERC, it raises a number of issues relevant to the matter remanded by the Court.

In addition, evidence has come to light in recent weeks that various interested parties allegedly engaged in deceptive practices with the purpose and effect of manipulating gas price indexes. The Select Committee on Energy Market Manipulation of the California State Senate, chaired by Senator Dunn, heard testimony from a former manager of a key gas market index about the use of false, incomplete, and inaccurate reports and the use of so-called “wash trades” to manipulate indices by entities such as Enron who were owners of QFs during the remand period.⁷ The Commodities Futures Trading Commission (CFTC) recently settled an investigation of Dynegy and its partner West Coast Power LLC, who were owners of generating facilities in California including QFs during the remand period.⁸

PA02-2-000), prepared by the Staff of the FERC, August 2002.

<http://www.ferc.fed.us/electric/bulkpower/pa02-2/Initial-Report-PA02-2-000.pdf>

⁷ Sworn Testimony of Michelle Markey before the Senate Select Committee on Electric Price Manipulation, December 6, 2002.

⁸ In the Matter of Dynegy Marketing and Trade and West Coast Power LLC, CFTC Docket 03-03, December 18, 2002, available at <http://www.cftc.gov/files/enf/02orders/enfdynegy-order.pdf>; see also, “Political Tides Brought Harsh Lesson for Energy Traders,” Dow Jones Newswires, December 31, 2002.

Discussion

In order to fulfill the directive of the Court, this ruling provides parties an opportunity to address the issue of SRAC prices during the period December 2000 through March 2001 by responding to the following questions:

1. If you are a party that believes SRAC prices were correct for this period, what evidence do you offer to substantiate your position?
 - a. Do you also believe that the gas index used in calculating SRAC was correct? Why?
 - b. Did you submit gas price information to any index publication, directly or indirectly (through EnronOnLine or other gas trading platform)?
2. If you are a party that believes SRAC prices were incorrect for this period, what evidence do you offer to substantiate your position?
 - a. What are the correct prices that should have been charged?
 - b. What is your basis for calculating these corrected prices?
 - c. Are you basing your position on use of a different gas index?
 - d. What gas index should be used in calculating SRAC for this period, and why is it reliable?
 - e. Should the SRAC formula adopted in D.01-03-067 be applied retroactively to this period as directed in the Court's opinion?
3. If SRAC prices for this period were incorrect, what process should be used to return the difference between correct SRAC prices and incorrect SRAC prices to the utilities?
4. Should a weighted average cost of gas (WACOG) be used in determining a gas index? Is the use of WACOG as a gas index in SRAC subject to manipulation similar to the manipulation of gas indices discussed above? Note that Edison set forth a detailed WACOG proposal in its November 28, 2000 Emergency Motion

filed in R.99-11-022 at pages 5, 14, 25-26. Does Edison's WACOG proposal comply with Section 390? With PURPA?

5. The FERC staff report recommends calculating correct gas prices based on spot prices at producing area pricing points plus an allowance for transportation to California. Is this a reliable method to calculate the correct gas prices for the December 2000 through March 2001 period at California border points? Is the Commission precluded from using such a methodology under Section 390(b)?

6. Does the difference between correct SRAC prices and incorrect SRAC prices apply to all QFs?

7. In a non-robust market situation, does Section 390 conflict with PURPA regarding the determination of avoided cost? If so, how should the Commission address this? Is it reasonable to require that SRAC be computed according to a WACOG-type index in the event that any of the border indices are found to be non-robust? Are there other approaches that should be considered?

To the extent that any of these questions raise legal issues, parties should brief those issues and provide citations.

IT IS RULED that:

1. Parties desiring to provide comments on the questions listed in this ruling may do so. Any comments shall be filed and served by January 31, 2003.

2. Parties desiring to provide reply comments may do so. Any reply comments shall be filed and served by February 18, 2003.

Dated January 14, 2003, at San Francisco, California.

/s/ BRUCE DeBERRY
Bruce DeBerry
Administrative Law Judge

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Administrative Law Judge's Ruling Requesting Comments and Reply Comments on Short-Run Avoided Cost Prices and Natural Gas Indices Used Between December 2000 Through March 2001 on all parties of record in this proceeding or their attorneys of record.

Dated January 14, 2003, at San Francisco, California.

/s/ CLAIRE JOHNSON
Claire Johnson

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to ensure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.